LEGISLATIVE SERVICES AGENCY

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FISCAL IMPACT STATEMENT

LS 6858
BILL NUMBER: HB 1349

NOTE PREPARED: Feb 16, 2015
BILL AMENDED: Feb 16, 2015

SUBJECT: Various Tax Matters.

FIRST AUTHOR: Rep. Huston
FIRST SPONSOR:

BILL STATUS: CR Adopted - 1st House

FUNDS AFFECTED: X **GENERAL**
X **DEDICATED**
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) The bill contains the following provisions:

Income Tax - Adjustments, Deductions, and Credits: It eliminates various adjustments to income for purposes of determining Indiana Adjusted Gross Income (AGI). It also eliminates various income tax exemptions, deductions, and credits.

Indiana Earned Income Tax Credit: It uses the most recent Internal Revenue Code (IRC) for determining the Indiana Earned Income Tax Credit (EITC).

Business Income Taxation: It provides that business income is all income apportionable to the state under the Constitution of the United States.

Repeal of Throwback rule: It eliminates the taxation of income that is attributed to a state that does not have an income tax (the "throwback rule").

Apportionment of Income: It provides that sales of a broadcaster that arise from the broadcast or other distribution of film programming or radio programming are in this state if the commercial domicile of the broadcaster's customer is in this state.

Intangible Expenses Add back: It broadens the addback to Indiana AGI related to intercompany interest expenses.

Tax Amnesty: It provides for a tax amnesty program.

The bill also makes technical corrections and conforming amendments.

Effective Date: July 1, 2015; January 1, 2016.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the changes made by the bill. With the exception of the required tax amnesty program, the DOR's current level of resources should be sufficient to implement these changes.

When the DOR conducted a tax amnesty program in 2006, the total cost was about $15.5 M. That included contracting with an outside collections agency to assist with the project because the DOR did not have the capacity or resources to contact all potential amnesty cases. It is unknown whether the DOR currently has the resources to conduct this project without outside assistance. The bill does not appropriate funds for a tax amnesty project. The additional funds and resources required could be supplied through existing staff and resources currently being used in another program or with new appropriations. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend on legislative and administrative actions.

Explanation of State Revenues: (Revised) *Summary-* The table below summarizes the estimated impact of provisions of the bill. (Provisions with no fiscal impact were excluded.) Following the table are brief explanations of the provisions and potential revenue impacts. The provisions are categorized based on whether they are: (1) likely to increase state revenue, (2) likely to have no fiscal impact, or (3) likely to decrease state revenue.

Provision	**Estimated Impact ($ in millions)**		
	FY 2016	**FY 2017**	**FY 2018**
Tax Amnesty	$0	$109.0 -$159.0	$0
Business Income	*	*	*
Intercompany Interest Expense Add Back	*	*	*
Income Tax - Eliminating Adjustments, Deductions, and Credits	$0	$6.0	$6.0
Community Revitalization Enhancement District Tax Credit	*	*	*
Indiana Earned Income Tax Credit	$0	($12.8 - $15.8)	($12.8 - $15.8)
Repeal of Throwback Rule	($0 - $1.5)	($0 - $8.0)	($0 - $8.0)
Apportionment of Income	(*)	(*)	(*)
Total	**($0 - $1.5)**	**$102.2 - $141.2**	**($6.8 - $17.8)**

* Indeterminable fiscal impact.

<u>*Likely to Increase State Revenue*</u> -

Tax Amnesty: Under the bill, the DOR would adopt emergency rules to establish a tax amnesty program for listed taxes due and payable for a tax period ending before January 1, 2013. The program would not last more than eight weeks and would end before January 1, 2017. Using the average and median collection rates of similar programs, the proposed tax amnesty program could collect about $109.0 M to $159.0 M.

Business Income Taxation: The bill changes Indiana's definition of business income to all income that is apportionable to the state under the Constitution of the United States. This affects what income the taxpayer must apportion when computing Indiana source income. This will likely increase state revenue by an indeterminate amount particularly from gains on liquidating sales and certain unitary transactions. The revenue impact will likely begin in FY 2016 as corporations with liability periods ending in the first half of CY 2016 file their returns, but the full revenue impact will begin in FY 2017.

Intercompany Interest Expense Add Back: The bill clarifies the current law related to an add back of interest expense deduction taken on a corporation's federal income tax return for certain interest expenses paid, accrued, or incurred by the corporation with one or more members of the same "affiliated group" of corporations or with one or more foreign corporations. This provision could lead to an increase in compliance by taxpayers that disregard the current add back provision due to lack of clarity in the statute.

(Revised) *Income Tax - Adjustments, Deductions, and Credits:* The bill eliminates 20 income tax adjustments, deductions, and credits beginning after December 31, 2015. The net impact of eliminating these provisions could potentially increase state General Fund revenue about $6.0 M each year beginning in FY 2017. [Please see the table at the end of this document for a complete list of the provisions eliminated by the bill.]

Income Tax - Community Revitalization Enhancement District Tax Credit: The bill also modifies the Community Revitalization Enhancement District Tax Credit. It states that expenditures made on residential property after December 31, 2015, are not considered qualifying investments when computing the tax credit amount. This provision will likely have an indeterminable, but insignificant impact, on state General Fund revenue beginning in FY 2017.

<u>*Likely to Have No Fiscal Impact*</u> -

Indiana Earned Income Tax Credit: Eliminating the references to advanced EITC payments will have no fiscal impact. Federal legislation signed into law August of 2010 repealed the advanced EITC effective December 31, 2010.

<u>*Likely to Decrease State Revenue*</u> -

Indiana Earned Income Tax Credit (EITC): The bill modifies the computation of the Indiana EITC. Currently, the credit equals 9% of the federal EITC as it existed before amended by the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.* The bill updates the federal EITC reference to the date the Internal Revenue Code (IRC) is referenced in Indiana statute. This will increase the credit provided to individuals and reduce state General Fund revenue by the amount of credits claimed. The revenue impact will likely begin in FY 2017 when individuals file their tax year 2016 returns. This provision will likely reduce state revenue by about $12.8 M to $15.8 M per year. Future revenue losses will depend on the number of claimants, federal law, and whether the reference in Indiana statute to the IRC in effect on a particular date is updated to include such legislation.

Repeal of Throwback Rule: The bill changes the apportionment method of corporate business income for corporate taxpayers that: (1) ship property from Indiana to a purchaser located outside Indiana; and (2) are not subject to tax in the jurisdiction where the purchaser is located. Under current law, the sales described in (2) are assigned to Indiana under what is called the "throwback rule". Since Indiana uses sales as the basis of business income apportionment, the throwback rule increases the taxable business income for some corporate taxpayers.

It is estimated that the state revenue loss from eliminating the throwback rule could range from minimal to $8.0 M annually. The long-run impact could decline due to scheduled tax rate reductions. The estimated range is based on a review of econometric research on the impact of the throwback rule on the corporate tax base and revenue and an analysis of Indiana corporate tax return information.

Econometric research on the impact of the throwback rule on the corporate income tax base has been largely ambiguous. Some of the studies suggest that eliminating the throwback rule could lead to a revenue loss, but that the revenue loss might be offset to the extent that the change leads to an increase in taxable corporate income due to tax planning and other factors. However, some of the studies suggest that the throwback rule does not impact the corporate tax base on its own, but may impact the tax base when combined with other policy factors like the corporate tax rate and combined reporting requirements. Corporate tax return information suggests that less than 1% of corporate taxpayers are currently impacted by the throwback rule A simulation removing the throwback rule for these taxpayers indicates it would reduce the tax liability of these taxpayers. The final estimate assumes a behavioral response by corporate taxpayers could offset a portion of the simulated revenue. The behavioral response rate is based on econometric research estimating the tax base response to statutory and effective tax rate changes.

The bill is effective January 1, 2016, and the impact of the bill could begin in FY 2016, if taxpayers adjust quarterly estimated payments. The full year impact from the bill would begin in FY 2017.

(Revised) *Apportionment of Income:* The provision changing the apportionment formula for broadcasters will have an indeterminable decrease on the Corporate adjusted gross income (AGI) tax deposited in the state General Fund. Assuming that the taxpayers will make an adjustment to their estimated payments, any impact will begin in the second half of FY 2016.

Additional Information -

Tax Amnesty: Under the amnesty program, applicable interest, penalties, collection fees, and costs would be excused on liabilities voluntarily paid or for which a payment program acceptable to DOR is established. Also, DOR would not seek civil or criminal prosecution of the taxpayer or issue an assessment, warrant, or demand notice against the taxpayer. However, if the taxpayer fails to pay the tax liability eligible for payment under the program, the liability would be subject to a doubling of penalties imposed or otherwise due. An exception to the doubling of penalties would exist for certain taxpayers who timely file an original tax appeal in the Tax Court, who have a legitimate hold on making the payment, who proves to the Commissioner that notice of the outstanding tax liability was never received, or who have established a payment plan with DOR. Additionally, a taxpayer would enter into an agreement that the taxpayer would not be eligible for any future amnesty program for the same listed tax. DOR would be required to enforce the agreement.

Indiana conducted an amnesty program in 2006, and it yielded $244 M in revenue. The table below contains the source of prior amnesty collections by tax type.

Tax Type	% of Amnesty Revenue
Corporate Income and Financial Institutions Tax	46%
Sales and Use Tax	25%
Individual Income Tax	24%
All other tax types	5%

The amnesty collection estimates are based on published research, the effectiveness of similar state amnesty programs, and the results of Indiana's prior amnesty program. The actual revenue from the proposed amnesty program depends on the total qualified tax liabilities, the success of marketing the program, and the liabilities of the taxpayers who participate in the program.

Income Tax - Adjustments, Deductions, and Credits: The estimates are based on actual claims by taxpayers, reports published by the Joint Committee on Taxation, and current federal law. Many of the adjustments are linked to federal tax provisions that have expired. Consequently, repealing these provisions would not impact AGI tax revenue unless: (1) the Congress enacts legislation to extend the provisions beyond tax year 2015; and the reference in Indiana statute to the IRC in effect on a particular date is updated to include such legislation.

In addition, the bill requires taxpayers continue to adjust their income as if certain provisions were not eliminated until tax year 2020. In tax year 2020, the bill requires taxpayers to make all necessary income adjustments associated with the adjustments for accelerated depreciation for disaster assistance property, to expense certain refinery property, to expense film and television production costs, and the loss of the preferred stock treated as ordinary income. The FY 2021 revenue loss associated with these adjustments is indeterminable. It is assumed that some taxpayers will continue to carry forward unused credits. The bill does not prevent taxpayers from carrying forward unused credits if it was authorized by the specific credit statute.

(Revised) *Apportionment of Income:* Under current practice, the state portion of receipts for television or radio station or network of stations for broadcast is calculated using the audience factor. The audience factor could be generally defined as the ratio that the taxpayer's in-state viewing (listening) audience bears to its total viewing (listening) audience. For film programming by a cable television system the audience factor uses the ratio that subscribers located in state bears to the total subscribers of such broadcaster.

The bill will change the method of calculating the in-state sales for the purpose of income apportionment for the broadcasters. It requires that the receipts from advertising and licensing be considered in Indiana if the commercial domicile of the broadcaster's customer is in Indiana. The fiscal impact from the bill depends on the magnitude of the difference in the broadcaster's income apportionment to Indiana and whether it is larger or smaller than the income apportionment under current law.

<u>Explanation of Local Expenditures:</u>

Explanation of Local Revenues: (Revised) *Local Option Income Taxes (LOIT):* Eliminating various state income adjustments and deductions will affect Indiana taxable income, so counties imposing local option income taxes (LOIT) could potentially experience a change in revenue. The bill also repeals the county income tax credit for the elderly or permanently disabled. LOIT collections on a statewide basis could be increased by an estimated $2.4 M in FY 2016 and FY 2017. The additional revenue will continue in subsequent years.

In 2012, the county income tax credit for the elderly or permanently disabled was claimed by 677 taxpayers and reduced statewide LOIT revenue by $23,875.

State Agencies Affected: Department of State Revenue; Indiana Economic Development Corporation; Office of Community and Rural Affairs; Indiana Housing and Community Development Authority; Indiana State Education Department; Indiana Department of Natural Resources; Ports of Indiana.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: LSA Income Tax database; Joint Committee on Taxation; Wolters Kluwer CCH, *2015 U.S. Master Tax Guide*, November 2014. *Tax Increase Prevention Act of 2014*, H.R. 5771, P.L. 113-295, 12/19/2014. Mengle, Rocky, *State Apportionment of Business Income,* Wolters Kluwer CCH White Paper, September 2014; Indiana Department of State Reveneu, *Indiana Tax Amnesty Final Report,* July 1, 2006; Federation of Tax Administrators, *State Amnesty Programs November 22, 1982 – Present*, September 14, 2014; Resnick, Phyllis, *The Effectiveness of Tax Amnesty Programs: 1982-2002*, Center for Tax Policy, 2002; U.S. Census, *State Government Tax Collections*; Bureau of Labor Statistics, Quarterly Census of Employment and Wages, 2013 Fourth Quarter, Private, All Industry; Indiana Department of State Revenue, *Tax Competitiveness and Simplification Report*, September 2014; Allied-Signal, Inc. v. Director, Division of Taxation, 504 US, 768 (1992), No. 91-615. National Tax Journal. Multi State Tax Commission, http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/SpecialRules-TVRadio.pdf

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Impact of Income Tax Adjustments, Deductions, and Credits Eliminated By the Bill		
Tax Provision	**FY 2017**	**FY 2018**
Certain trade or business deductions based on employment of unauthorized alien adjustment	($3,000)	($3,000)
Discharge of debt of a principal residence adjustment	$0	$0
Federal economic stimulus payment of 2008 deduction	$0	$0
Historic rehabilitation credit	$184,000	$189,000
Individual development account credit	$96,000	$98,000
Insulation deduction	$1,064,000	$1,024,000
Law enforcement reward deduction	$1,000	$1,000
Lump sum distribution from qualified plans of participants born before January 2, 1936 adjustment	($132,000)	($129,000)
Maritime opportunity district qualifying export income deduction	$0	$0
Medical savings account deduction	$82,000	$89,000
Non-Indiana locality earning deduction	$3,760,000	$3,699,000
Partial Indiana lottery winnings deduction	$560,000	$530,000
Qualified disaster assistance property adjustment	$0	$0
Qualified film or television production adjustment	$0	$0
Qualified preferred stock (Fannie & Freddie losses) adjustment	$0	$0
Qualified refinery property adjustment	$0	$0
Residential historic rehabilitation credit	$237,000	$241,000
Solar roof vent fan deduction	$7,000	$8,000
Tax credit for computer donations to certain educational facilities	$0	$0
Unemployment compensation payment in 2009 adjustment	$0	$0
Total	**$5,856,000**	**$5,747,000**